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HOLDING COMPANIES AND THE PUBLIC WELFARE

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I understand a "holding company," as we employ the term, to indicate a corporation controlling the properties and management of another (known as an operating company) through ownership of the stock of the latter, as distinguished from direct title to the properties of the latter. The holding company may be solely such, or it may be to some extent an operating company itself.

I further understand that "anti-trust" and "anti-monopoly" laws are not involved in this discussion; but that the question involves the effect upon the public welfare of control by capitalists of operating properties through the medium of a holding company rather than through direct ownership of such operating properties, where such control or ownership would not involve the violation of the statutes mentioned. I shall confine my thought to holding companies affecting "public utilities," particularly those of a local character, such as gas, electric, water and street railway enterprises.

To consider the relation of "holding companies and the public welfare," it is necessary to approach the subject from an unprejudiced standpoint; and so far as that qualification goes I feel that I possess it. I neither "see red" nor am I filled with unusual joy on hearing the expression "holding company." I have no prejudice either for, or against, such a device. I am, however, impressed by study and observation with the truth of the proposition that any business movement of such vast proportions as the development of holding companies within the last fifteen years must rest upon some broad economic foundation. It is history that such movements are commonly based upon the necessities and progress of business evolution, and that at the outset they represent a real advance and an instrument of efficiency. The great majority of business men, even men of large business, are not "malefactors of great wealth" or otherwise, but plain humans endeavoring to develop their activities to meet the actual and proper calls of the public, by improvement of service through employment of legitimate means. This tendency

explains beyond question the origin of the device known as the "holding company," whatever may be thought of its use or development or possible abuse thereafter.

The holding company has undoubtedly in some instances been perverted to bad ends. An illustration, on a colossal scale, appears in the exploitation of the Chicago, Rock Island and Pacific Railway, where one holding company was formed for the purpose of acquiring the stock of the railway company by the issue of collateral bonds, and a second holding company was formed to acquire the stock of the first holding company under a charter by which the entire control of the latter and consequently of the railway company itself was assured to the holder of the preferred stock of the second holding company, representing but a small proportion of its entire capitalization. Such a scheme is its own executioner, as the existing situation of that enterprise forcibly demonstrates.

Then, too, there is the holding company that is merely useless; it is of no particular value economically or in any line of efficiency; it exists only because someone prefers that method of control; it is simply a fifth wheel to the coach. While I have no use for a fifth wheel to my coach, I am not disposed to get out of patience with any man who prefers one for his, or to try to prevent his using one if it pleases him and does me and the community at large no harm. It is, and for that matter ought to be, part of the liberty of the citizen to do harmless things in foolish ways if he prefers, rather than to proceed wisely, provided he does not injure his neighbors by his action.

But the great majority of holding companies exist to meet a real need; they add immensely to the development and the efficiency of the service of public utilities, and inure enormously to the benefit, not only of their immediate customers, but also of the entire communities in which such utilities are located.

Facility of Financing

In the first place, holding companies make possible the procurement of capital in the development of public utilities throughout the land which would be developed either not at all, or incompletely and inefficiently, but for the existence of such a device. Very few communities, even large ones, are able to draw from their own resources

funds adequate to construct and develop public services of the highest and most progressive type. Almost invariably capital is sought from without; and it is above all things desirable, and especially for those sections of the country which are less fully developed, to be able to tap freely the reservoirs of capital in the older and richer sections of the Union and abroad.

To secure the advancement of funds requisite for these purposes, capital must be consulted as to the method of procedure which it prefers to pursue; it is not something which can be commandeered willy-nilly; the only options presented to it are either direct investment in local plants, frequently broadly scattered, or investment in a holding company which shall control them at a common centre by stock ownership and advance funds to them in return for their securities. But capitalists do not as a rule care, or are willing only to a limited extent, to make comparatively small investments here, there and elsewhere in different communities of the Union, in such a form that they must keep their eyes upon each particular investment through representation on the board of directors or otherwise, in order to see that it is handled and maintained in such a manner as to insure a fair return on the investment. They prefer to make this investment in the holding company, whose officers and staff will exercise control and supervision of the subsidiary companies to which it may advance, relieving the investors of that responsibility and burden.

Moreover, great holding companies, such as many which I might name, and the names of which will spontaneously occur to my hearers, which hold the stock of public utility corporations and supply their needs in the way of electric current and otherwise, at various points throughout the Union, by reason of their prestige and financial strength are able to command in the centres of finance capital which it would be impossible for a local enterprise, thousands of miles from such centres and with no particular reputation with investors, to secure except at very high rates of interest if at all.

Safety of Investment

Moreover the capitalist, and especially the smaller investor whose means are not sufficient to allow him to embark in more than a single local enterprise if he were to take an interest therein directly,

very much prefers in the interest of safety an investment in a holding corporation whose property interests are diversified as to territory or character, or both, covering plants at five, or ten, or fifty different points, on the ground that if failure should occur at one, prosperity may be expected to follow at another, so that on the doctrine of averages his investment will still be reasonably safe instead of under the hazard of being wiped out by an unfortunate venture in a single plant.

And since, according to the decisions of our highest courts, a fair return upon capital depends to some extent upon the hazard of the investment, it will at once appear that if through the medium of a company holding scattered plants the hazard of the investor is rendered less than it would be if his eggs were all placed in a single basket, he would be willing and could perhaps be compelled to accept a lower rate of return upon his capital. So that the employment of the holding company, with its reduction of individual hazard, may reasonably be expected to inure to the benefit of the customers of the operating company in the shape of lower charges for service.

Greater Efficiency

Again, a holding company of large resources can and usually does command engineering and executive skill of a quality, and can acquire supplies in wholesale quantities at a price, and frequently controls sources of energy which it is able to distribute at a rate per unit, impossible to a local company relying upon its own resources.

The result of these advantages, so far as it concerns the subsidiary companies, should be and I think as a rule is, a more efficient operation, under more skilled supervision, and a more rapid extension of service to the communities affected than would otherwise be possible. Thus a great electric company is able by reason of the larger investment which it can make in plant, to produce power and other facilities for manufacturing and commercial concerns, not only within a fixed municipality but outside of its limits and adding to its growth, at a rate of progress and of charge for service unknown to the purely local enterprise; with the result of a community development and prosperity which could never have been secured under the cramped and limited conditions theretofore prevailing. Such use of the product for manufacturing and commercial purposes, as

well as for illumination, increases greatly the "load factor" and the output per unit of capital investment, and consequently reduces the cost per unit of the product, with the possibility of a reduction of rates to old consumers as well as the furnishing of additional facilities to new enterprises.

Thus the United States census report of 1912 as compared with the like report for 1902 shows a reduction in cost of current at commercial electric stations from 3.4 cents in 1902 to 2.5 cents in 1912, or more than 25 per cent, due largely to the development of holding companies, with immense plants and economies of production per unit which they have been able to accomplish. As showing the relative efficiency of such companies it may not be amiss to observe that municipal electric lighting stations within the same period by the same two reports show an increase from 3.6 cents in 1902 to 4.3 cents in 1912.

Legal Considerations

But there are other and important reasons for the existence of holding companies, rather than direct ownership of scattered plants by a single corporation. Scattered public utility plants in many instances could not be directly owned by a single company, even if investors preferred direct ownership to ownership of stock in local plants by a central company. By the laws of a great part of the states of the Union a public utility such as a gas or electric or railway company can operate only under a charter granted by the state in which it is located; in many, franchises to operate in public highways cannot be exercised except by a corporation of that state; and, if in any states a public service corporation might be directly operated by a foreign corporation, it would be only under inconvenient and undesirable conditions which would tend to discourage rather than invite free investment of outside capital.

Again, the property of an existing public utility corporation could ordinarily be directly acquired only by unanimous consent of its stockholders or by vote (in some states) of two-thirds or some other very large proportion thereof. But a group of capitalists making a specialty of the management of such utilities, may not care to make so large an investment in particular plants for two reasons: first, they prefer to acquire simply a majority of the interest in individual enterprises so that their resources may be devoted to

a larger number of plants, and in the second place they prefer to have a portion of the enterprise remain locally owned, on account of the touch which may in that manner be maintained with local interests and sympathy. Moreover, it is a matter of common knowledge that holders of some part of the stock of a public utility will commonly hold out for a prohibitive figure, even if the new investors are willing to acquire an entire interest in the local enterprise. The minority holder in the local enterprise, is protected by the circumstance that the purchasers of control can obtain a return on their investment only by such management and improvement of the property as will pay a return to all stockholders alike.

Moreover, many, and probably most, public utility corporations, are compelled from time to time to exercise the power of eminent domain; to condemn property or rights of way for efficient operation; and in most if not all of the states no corporation foreign to that state can exercise such powers. Without this authority, a foreign corporation, even if otherwise legally qualified, would be constantly hampered by the necessity of acquiring necessary rights at any exorbitant figure which the owner thereof saw fit to charge, the natural tendency of which would be to increase expenses of operation, or the amount of capitalization upon which the rates paid by customers must provide a return.

Distinction between Public Utilities and Other Corporations

The holding company, so far as it relates to public utilities, is not open to the objection which has been strongly urged against holding companies in commercial business. A commercial holding company, or operating company for that matter, may do business in and send goods into every other state in the Union; it may cover such states with its salesmen, whose operations may not be interfered with by any state without violating the law giving the federal government exclusive jurisdiction over interstate commerce; it may be located in Pennsylvania and not have a dollar of investment in any other state; it is dealing directly with any number of citizens and entire communities in such other states; and yet if anything in its action is subject to condemnation it cannot be reached by the courts of the other states whose citizens may have suffered, and virtually the sole remedy lies in the invocation of the federal statutes

known as the "anti-trust laws," with the Sherman Act at the head, which may have no application at all in the situation.

But a public utility corporation, even though all its stock is owned by a corporation located in another state, must from the very nature of its business, be located in the community which it serves; there are its property and its operations; there are located its offices which deal with the people; its rates and service and methods are subject to the regulation of the state where it is located, through the commission or other administrative body given jurisdiction in the premises; and it is just as amenable in every respect to the authorities of the state as though every dollar of its stock were owned by citizens of that state.

Indeed, if the stock of such a public utility corporation be owned by a foreign corporation, the situation is distinctly better than it would be if the foreign company had acquired the assets of the operating company directly instead; for in the former case the orders of a commission or the judgment of a court in relation to the operations of the public utility can be served directly upon the corporation owning the property, because there is a local corporation; while, if the property is directly owned by a foreign corporation, any proceeding of the state authorities would be simply *in rem*, against the local property alone, and the corporation owning it might be for all other purposes entirely beyond the jurisdiction of such authorities. The foreign corporation owning directly the assets might snap its fingers at the local authorities, except as to the immediate property upon which such authorities could place their hands; while in case the property was owned by a local corporation and the stock of the latter by a holding company, the state would have every legal and personal remedy against the local corporation which it could have if its stock were altogether owned by individual residents, the courts not recognizing the location of the stock ownership as at all material in determining a remedy or judgment against the operating company.

Conclusion

In conclusion the belief is expressed that the centralization of financing and management which is made possible by the holding company, or which is made possible by a centralized holding by any other method, is of vast and growing importance to the development

of the country in the line of public utilities and the activities of the community which are dependent thereon or connected therewith.

The element of destruction of competition which is said to lead to monopoly, is not present; for scattered public utilities at different points never, or only in rare instances, could be competitors with each other.

Moreover, being subject to state regulation, their charges to and treatment of consumers may be controlled for the public good, and in certain public utilities at least, a regulated monopoly is more conducive to the convenience and good service of the public than any amount of competition.

The holding company has come to stay, because it ought to stay; because it is an instrument of progress and efficiency and development; and its elimination would be a misfortune whose consequences would be difficult to calculate, but certainly immense.